

## **103 KAR 16:310. Domestic production activity deduction.**

RELATES TO: KRS 141.010(13), 26 U.S.C. 199, 26 C.F.R. 1.199-0 -1.199-8t

STATUTORY AUTHORITY: KRS 131.130(1)

NECESSITY, FUNCTION, AND CONFORMITY: KRS 141.010(13) provides that net income, in the case of corporations, means gross income as defined in KRS 141.010(12) minus the deduction allowed by KRS 141.0202 and minus the deductions from gross income allowed corporations by Chapter 1 of the Internal Revenue Code, 26 U.S.C. Chapter 1, and as modified by KRS 141.0101, except the certain deductions listed in KRS 141.010(13). KRS 131.130(1) authorizes the department to promulgate administrative regulations to administer and enforce Kentucky's tax laws. Net income in the case of taxpayers other than corporations is defined in KRS 141.010(11). This administrative regulation explains the domestic production activity deduction as allowed by Internal Revenue Code 199, 26 U.S.C. 199.

Section 1. Definitions. (1) "Apportionment factor" is defined in KRS 141.120(8)(c) and computed for the separate return filer or the EAG.

(2) "Corporations" means:

(a) For elective consolidated return filers, corporations as defined in KRS 141.200(2)(d); and

(b) For separate return filers or nexus consolidated return filers, corporations as defined in KRS 141.010(24).

(3) "DPAD" means domestic production activity deduction as defined in Internal Revenue Code 199, 26 U.S.C. 199.

(4) "DPGR" means domestic production gross receipts as defined in Internal Revenue Code 199, 26 U.S.C. 199(c)(4).

(5) "EAG" means expanded affiliated group as defined in proposed regulation 1.199-7(a)(1), but shall not include corporations exempt from taxation pursuant to KRS 141.040(1).

(6) "Elective consolidated return filer" means those corporations as defined in Section 7701(a)(3) of the Internal Revenue Code, 26 U.S.C. 7701(a)(3), filing in accordance with KRS 141.200(3) and (4).

(7) "General Partnership" is defined in KRS 141.206(1)(a).

(8) "Internal Revenue Code" is defined in KRS 141.010(3).

(9) "Nexus consolidated return filer" means those corporations, as defined under KRS 141.010(24), filing in accordance with KRS 141.200(8) to (14).

(10) "QPAI" means qualified production activities income as defined in 26 C.F.R. 1.199-1(c).

(11) "Separate return filer" means those corporations filing in accordance with KRS 141.200(10).

Section 2. Adoption of Internal Revenue Service Regulations. 26 C.F.R. 1.199-0 to 1.199-8t shall be adopted for the computation of the DPAD, except for the amendments and exceptions listed in Section 3 of this administrative regulation.

Section 3. Amendments and Exceptions. In computing the DPAD attributable to Kentucky, the following amendments and changes shall apply in Kentucky:

(1) For 26 C.F.R. 1.199-1(b), the definition of taxable income for corporations shall be defined by KRS 141.010(14) adjusted by KRS 141.011.

(2) 26 C.F.R. 1.199-2 is amended to add the following: W-2 wages shall be computed pursuant to KRS 141.120(8)(b) and 103 KAR 16:090.

(3) For 26 C.F.R. 1.199-4(b), the depreciation expense that is deducted in cost of goods sold shall be computed pursuant to KRS 141.0101 and as modified by KRS 141.010(3).

(4) 26 C.F.R. 1.199-5(b) regarding S corporations shall not be applicable.

Section 4. Application of the DPAD. (1) For corporations, the DPAD shall be computed as follows:

- (a) Multiply the QPAI by the apportionment factor of the separate entity filer or EAG;
  - (b) Multiply the applicable percentage in Internal Revenue Code 199, 26 U.S.C. 199, by the lesser of the amount computed in paragraph (a) of this subsection of this administrative regulation or the taxable income of the separate return filer or taxable income of the EAG as computed in Section 3(1) of this administrative regulation;
  - (c) The DPAD shall be limited by the amount of Kentucky W-2 wages as computed in Section 3(2) of this administrative regulation;
  - (d) Allocate the deduction pursuant to the provisions of 26 C.F.R. 1.199-7, if the DPAD is based upon EAG; and
  - (e) Take the DPAD after the net operating loss deduction in computing taxable income.
- (2) For taxpayers other than corporations:
- (a) Full-year residents shall be allowed the federal deduction for DPAD;
  - (b) Part-year or full-year nonresidents shall prorate the allowable federal deduction based upon the percentage of Kentucky DPGR to federal domestic production gross receipts, with a further limitation that the DPAD shall not exceed fifty (50) percent of Kentucky W-2 wages; and
  - (c) The DPAD shall be taken when computing Kentucky adjusted gross income.

Section 5. General Partnerships. The distributive share of DPAD items shall be passed through to the individual partner.

Section 6. This administrative regulation shall be effective for tax periods beginning on or after January 1, 2005. (32 Ky.R. 2201; 33 Ky.R. 74; eff. 8-7-2006.)